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A Turn Back to "Poison Pills" in Response to the Coronavirus Pandemic?

The Coronavirus pandemic has been both a public health and an economic disaster. Stock prices have declined precipitously. As a result, many companies are turning their attention to whether their corporate governance structures enable them to protect their long-term shareholders from those who may seek to exploit the current situation by amassing a significant position in the company, at an extraordinarily low price, with the objective of pursuing goals that may not be in the long-term best interests of the company and its shareholders. Of note, in just the past several days, four large companies have adopted shareholder rights plans (so-called "poison pills") to protect against unauthorized accumulations of their stock. A total of ten companies have adopted rights plans in the last few weeks.

Key Points

- **In response to the effects of the coronavirus pandemic, companies are considering the adoption of shareholder rights plans.** Rights plans, which once were ubiquitous among larger companies, fell out of favor with institutional investors and the leading proxy advisory firms in the early 2000's and have not been widely utilized since then (although many companies have plans "on the shelf," ready to be deployed if necessary). Due to the extraordinary challenges for businesses resulting from the pandemic, and the related unprecedented volatility in the global financial markets, we expect that more rights plans may be adopted--particularly by companies in industries that are the most affected by the pandemic.

- **The four large companies that have adopted rights plans over the past several days share certain characteristics.** In each case, (i) the company is in either the energy industry or the entertainment industry; (ii) the company experienced a truly dramatic recent stock price decline, disproportionate to the general decline; and (iii) at the time the plan was announced, the company was the subject of an unsolicited takeover offer or active takeover speculation. In two cases, the company's announcement specifically referenced the coronavirus pandemic.

- **Some of the rights plans adopted in the past few days vary from what has been typical historically.** As discussed below, in one case, the rights plan has a 5% (rather than the typical 10% to 20%) ownership threshold trigger; and, in another case, the continuation of the rights plan is subject to shareholder approval.

Shareholder rights plans. Shareholder rights plans deter stock accumulations not authorized by the company by imposing substantial dilution on any shareholder or group that acquires more than a specified ownership percentage of the company without prior board approval. The risk of the economic dilution deters the unauthorized acquisition of shares above the threshold ownership trigger. Absent a rights plan, the only substantive prohibitions on the immediate acquisition of shares are the limits under

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the HSR Act--which are not applicable in all situations, may be structured around (such as by acquiring derivative instruments), and, even if applicable, currently permit acquisitions up to $94 million. Given the decline in market value for some companies, HSR currently may not be a meaningful impediment to an acquisition of control.

As noted, while rights plans were once ubiquitous among larger companies, since the early 2000s, few companies (especially larger companies) have had rights plans in place. At the end of 2019, only 8 of the S&P 500 companies had rights plans (of any type) in effect. At the same time, a rights plan remains the most effective potential tool for a public company to deter unwanted accumulations of its shares. Thus, many companies have a rights plan "on the shelf," ready to be deployed quickly in response to a potential accumulation or takeover threat. Under Delaware law, a rights plan can be adopted by a board of directors, without shareholder approval.

Typical terms of rights plans historically. Institutional investors and the leading proxy advisory firms now generally expect that, if a rights plan is considered by a board, it will be only for a limited duration and only in response to a specific threat that, based on the circumstances, could be unfair to shareholders. The typical features of these plans have been: (i) an ownership threshold trigger of 20% of the outstanding shares for Schedule 13G filers (*i.e.*, investors who are "passive"); and a trigger of 10% for other investors; and (ii) a term of one year (with, in some cases, the plan extending for three years with shareholder approval).

Rights plans adopted in the wake of the 2008-2009 recession-- "NOL plans." While most rights plans have been adopted to protect against abusive takeover practices, NOL plans protect a corporation's ability to use net operating loss carryforwards (and other tax attributes). These plans gained prominence in response to the 2008-2009 recession, during which many corporations generated significant NOLs (which can be used to reduce future income tax liabilities). Because, under the tax laws, changes in share ownership can limit a corporation's ability to use NOLs in the future, these rights plans are designed to restrict the relevant changes and thus typically have a threshold ownership trigger of just below 5%. While the purpose of these plans is different from that of a takeover-defense plan, the mechanics are largely the same except for the lower ownership threshold trigger.

Rights plans adopted in the wake of the coronavirus pandemic. The following companies have adopted rights plans in the last few weeks.

- **Williams Companies--*5% trigger.*** The Williams Companies, Inc., an S&P 500 company, announced on March 20, 2020 that it had adopted a rights plan. Williams is a natural gas infrastructure company, with a current $14 billion market capitalization (down from $35 billion within the last 12 months). Its stock price has declined more than 50% since its last earnings report about a month ago. The rights plan Williams adopted is unusual in that, although it is a takeover-defense rights plan, the ownership trigger is at 5% (rather than the typical 10% to 20% trigger). The very low ownership threshold trigger suggests that Williams may believe that it is particularly vulnerable, possibly in light of (a) the very dramatic and very rapid decline of its stock price notwithstanding its announcement that it had just completed its best financial and operational year ever and (b) its much lower market capitalization than previously, which now makes it a more feasible target for a larger number of potential acquirors. We note that a 5% trigger was sanctioned by the Delaware Supreme Court in its 2010 *Selectica* decision--in the context of an NOL rights plan, but the plan, as acknowledged by the court, also had a takeover-defense effect as the company was then facing an unsolicited takeover offer. The Williams Companies' stock price rose 6.6% the day of announcement of the rights plan (while the S&P 500 Index declined 4.3% and the S&P 500 Oil, Gas and Consumable Fuels Index rose 0.9%).

- ***Trigger***: 5%
- ***Duration***: 1 year
- ***Announcement***: The Williams Companies' announcement stated:

> In light of the company's strong position, the board wants to support the rights of shareholders and protect a fair value for their investment. We are witnessing a unique dislocation in equity market valuations, with particular impact to Williams' equity value. We do not believe the best interests of shareholders are served by allowing those only seeking short-term gains to take advantage of current market conditions at the expense of the company and its long-term investors.

- **Occidental Petroleum--*subject to shareholder approval.*** Occidental Petroleum Corp. ("Oxy"), an S&P 500 company, announced on March 13, 2020 that it would be adopting a rights plan this month. The plan will be put to a shareholder vote at the company's upcoming annual shareholder meeting (likely to be held in May 2020) and will expire immediately if not approved by the shareholders. Oxy has a market capitalization of $9.16 billion (down from $42.2 billion at the beginning of this year). Oxy's announcement followed a drop in its stock price of about 60% during the month, amid collapsing oil prices. Also during the month, shareholder activist Carl Icahn--who has been vocal in criticizing Oxy for its $37 billion purchase of Anadarko Petroleum Corp. last year and has been engaged in a campaign to replace the Oxy board--increased his investment in Oxy from a 2.2% stake to a 9.9% stake. The company's market value is now less than one-third of the price it paid for Anadarko. Icahn has announced that "strong bids" will eventually emerge for Oxy and they should be considered by a new board. This is one of the few times that continuation of a new shareholder rights plan is being put to a shareholder vote--reflecting, perhaps, uncertainty surrounding shareholders' receptivity to the rights plan. Oxy's stock price rose 19.9% the day of announcement of the rights plan (while the S&P 500 Index rose 9.3% and the S&P 500 Oil, Gas and Consumable Fuels Index rose 8.5%).
  - ***Trigger:*** 15%
  - ***Duration:*** 1 year
  - ***Announcement:*** The company's announcement did not specifically refer to the coronavirus pandemic.
- **Dave & Buster's.** Dave & Buster's Entertainment Inc., an S&P 600 company, announced on March 19, 2020 that it was adopting a rights plan. Dave & Buster's combines games, entertainment and dining at its businesses. It has a $237 million market capitalization (down from $1.4 billion in January). The company's stock price plummeted almost 90% over the month prior to announcement of the rights plan. In the two months prior to that, there was takeover speculation about the company--based on disclosure by one private equity firm that it had acquired a 7% stake and intended to advocate for changes in the company's capital structure, board and governance; and disclosure by another private equity firm that it had acquired an 8.3% stake. The stock rose 76.6% on the day of announcement of the rights plan (as compared to a rise of 0.5% for the S&P 500 Index and 9.1% for the S&P 500 Restaurant Index).
  - ***Trigger:*** 15%; or 20% in the case of institutional investors
  - ***Duration:*** 1 year

- ***Announcement:*** The company's announcement did not specifically refer to the coronavirus pandemic.

- **Delek.** Delek US Holdings Inc. announced on March 20, 2020 that it had adopted a rights plan. Delek is a downstream energy company with assets in, among other things, petroleum refining. It has a market capitalization of $1.1 billion (down from $2.5 billion in January--and $4.7 billion in June 2018). The plan was adopted following disclosure by Carl Icahn that he had acquired a 14.8% stake in the company with the intention of discussing a potential transaction between Delek and CVR Energy. The stock price was up almost 31% the day of announcement of the plan (while the S&P 500 Index declined 4.3% and the S&P 500 Oil, Gas and Consumable Fuels Index rose 0.9%).

  - ***Trigger***: 15%

  - ***Duration***: 1 year

  - ***Announcement***: Delek stated that it was open to exploring options, including potential business combinations, but that:

    > Given the fact that Delek's current share price does not reflect the company's intrinsic long-term value due to the extreme dislocation caused by the COVID-19 crisis and low commodity prices, we have no choice but to take action to prevent a creeping change of control without a premium on terms that would not deliver sufficient value for all shareholders.

Other rights plan adoptions. In addition to the four companies noted above, since the beginning of March 2020, two small-cap companies also adopted rights plans--on March 13, Ashford, Inc. (a provider of services to the hospitality industry); and, on March 19, Global Eagle Entertainment Inc. (a provider of inflight entertainment to the airline industry). Also, in March, three small-cap companies adopted NOL rights plans--on March 5, Drive Shack, Inc. (an entertainment company with a space with games and dining) on March 3, Aviat Networks, Inc. (a wireless services company); and, on March 10, Cohen & Company, Inc. (a provider of services to the investment industry). Thus, the total number of rights plans adopted through March 20 was nine--according to Deal Point Data, a monthly record since it started tracking rights plan adoptions in early 2017. In addition, on February 27, 2020, another company, LSC Communications, Inc. (an office products company), adopted a takeover-defense rights plan.

Practice Points

- **Companies should consider whether they may now or at some point in the future want to adopt a rights plan.** Companies should consider whether, in the current environment, they should adopt a rights plan or put one "on the shelf." If the company adopts a rights plan, outreach to key shareholders will be critical. Companies should carefully watch the trading activity in their stock and options to monitor changes in the shareholder base and signs of possible takeover or activist interest.

- **Companies considering adoption of a rights plan should consider whether to tailor the terms for the current circumstances.** One possible change in terms to be considered would be a lower ownership threshold trigger (as in the Williams Companies' rights plan). Given the objective of preventing third parties from acquiring significant ownership interests for very small dollar amounts that are not reflective of the company's intrinsic value, and given the extraordinary drop in market capitalization of many companies (in the Dave & Buster's situation, for example, a drop of almost 90%), a lower ownership threshold trigger may be appropriate. To illustrate: in the case of a company

that previously had a market cap of $1 billion (thus, a $150 million investment would be required to acquire a 15% interest, and a $50 million investment to acquire 5%), with a 90% drop in stock price, a very small investment would result in a significant ownership stake (only $15 million for a 15% interest, or $5 million for a 5% interest).

Another possible change in terms could be a shorter duration of the rights plan--for example, six months instead of the typical one year. (A duration of *longer* than one year would violate the key proxy advisory firms' voting policies and so would not be advisable unless these firms modify their policies in light of the current situation.) Another approach to consider might be tailoring the redemption provision to be tied to the current pandemic--*i.e.*, to provide that the plan can be redeemed by the board if (a) the company's stock price or its sector index value is equal to or higher than the highest price or value in the past, say, twelve months, and/or there is no longer a state of emergency declared, *or* (b) by the continuing directors. The validity of such a redemption provision is uncertain under Delaware law (as it could be viewed as similar to a "dead hand" provision).

- **Companies should consider whether their governance provisions relating to annual shareholder meetings are appropriate for the current environment.** One important consideration, given the current uncertainties and vulnerabilities for companies, is what the company's ability is to postpone or delay its annual meeting if the board wishes to do so.

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